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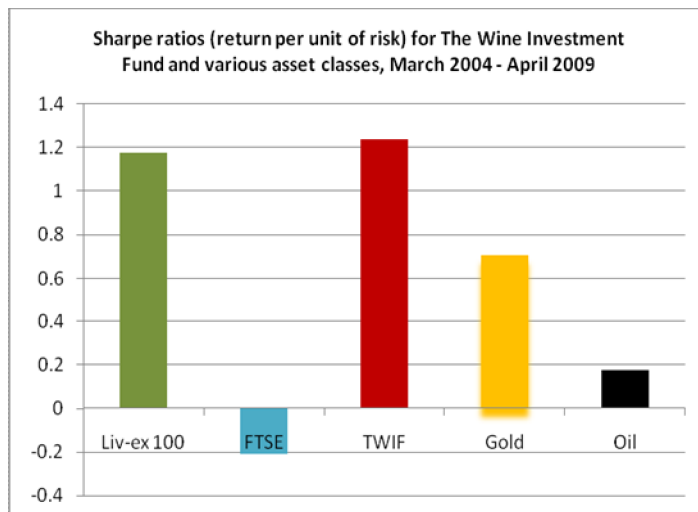
Fine Returns from Fine Wine

At a time when market volatility has hit other asset classes hard, an investment in fine wine holds several specific advantages. The Wine Investment Fund, the granddaddy of the publicly offered wine investment funds, has been successfully managing wine assets since 2003. Here's how and why.

Risk

Investment is all about risk and good investment choices are made when risks taken are clearly understood.

Risk is best expressed in terms of price volatility, with greater volatility bringing higher exposure to timing risk. Measuring a combination of absolute performance with price volatility, therefore, is useful for those looking to assess and maximise return on risk. The Sharpe ratio does exactly this and from the chart below it can be seen that fine wine outperforms the other asset classes shown. It has recorded not only attractive average annual returns (15%+ per annum), but has done so with lower price volatility than most investments.



The Liv-ex 100 Index is the traditional benchmark for fine wine market returns and is produced by Liv-ex, the fine wine exchange.

'TWIF' is The Wine Investment Fund.

Sources: www.liv-ex.com; London Stock Exchange; www.kitco.com; US Energy Information Administration; and calculations by The Wine Investment Fund

Supply/demand

The underlying supply and demand dynamics reinforce the attractive qualities of wine as an investment.

Bordeaux (and we consider only fine wine from Bordeaux as 'investment grade' for our purposes) is a finite geographical area in which are to be found a finite number of wine producers. Therefore, the wine produced by these producers, the 'Châteaux', is also finite.

But there's more. The quantity of any given wine from any given vintage can only decrease over time as it is consumed. Moreover, and uniquely, while supply is decreasing, demand is increasing because as fine wine matures it actually improves.

Demand for fine wine is now global, encompassing both the traditional markets of Europe and North America, and the newer markets such as Russia and the Far East. As the emerging economies become wealthier, the number of consumers grows.

With the decreasing supply of each given wine and the increasing demand as both the quality improves and the number of consumers increases, prices should rise. This is borne out in practice: the long-run growth rate of wine prices has been around 15.5% per annum. Despite recessions and economic downturns, the very top end of the fine wine market has never fallen dramatically in value (even in 2008, the market as measured by the Liv-ex 100 index fell 'only' 14.6%, and has recovered more than a quarter of that fall since).

Investing in fine wine

Of all the world's wines, only some 2% come from Bordeaux. However, only the top 40 to 50 of the 4,000 Châteaux in Bordeaux achieve the standards required for their production to be considered investment grade – less than 0.1% of the world's wine stock, and worth in total about £6 billion.

The key issues for any wine investor are 'what to buy?' and 'how much to pay?'. In deciding what to buy, concentration on any single producer or vintage should be avoided, and a decision made on whether to buy *en primeur* (i.e. wines at the pre-bottling stage of their life) and/or small production 'trophy' wines. In our case we have limits on the concentration in any producer or vintage and we do not buy *en primeur* or trophy wines.

We then turn to the specific selection of châteaux and vintages. During their period of aging, many great wines have quick short bursts of price increases, interrupted by price plateaux of varying lengths. The trick is to judge which wines and vintages are nearing a significant rise in value at the end of a plateau. The key factor is the state of maturity of the wine, which determines when larger quantities of it will begin to be consumed.

We then also look at the relative price of each wine (say Château Lafite 2000) in the wider market. This is complex as we know that Lafite generally commands a premium compared to most other Châteaux, and that the 2000 vintage also has a particular standing. Finally, there is the issue of critic's ratings – most famously the American writer Robert Parker. A wine with a higher score will typically trade at a higher price. So we strip out all of these factors to estimate a 'raw' price for the wine, which we can compare across potential purchases.

Once the difficult 'what to buy' issue has been resolved, we move on to 'how much to pay?'. Key here is the ability to look across the whole market, including London and Bordeaux, for the cheapest price (for stock in excellent condition and with sound provenance). This is a critical advantage of wine investment funds over brokers or merchants, as the latter will generally use their own stock at the price they themselves set – an inherent conflict of interest.

Top tips

Here are some tips to consider when selecting a portfolio of fine wine where the emphasis is on managing an investment portfolio (rather than laying down a wine cellar for drinking).

First, pick stock predominantly from the most famous wines of Bordeaux and from the best vintages. This minimises liquidity risk, as these wines are regularly traded on a mature secondary market. In addition, data is available to allow analysis of trends and price fluctuations.

Second, remember to take into account the costs of storage and insurance. For wines below the top tier, these can be high. A £250 case of wine might increase in value by 50% in 4 years, but the cost of storage and insurance over this time would, to a private investor, be about 5% of the asset value per year (trade storage could cost half this amount). The net return of around 30% is less impressive. But storage and insurance costs do not vary with the value of the wine, so this effect can be minimised by maintaining a high average price. Our average cost is around £2,500 per dozen bottles, meaning annual storage and insurance costs are less than 0.3% per year.

Third, price differentials, or bid/offer spreads, of a given fine wine may be as much as 30% in what is still an imperfect market. This can make private investment hazardous, but professionals will use multiple sources to ensure we only buy at the lowest prices (amongst stock in excellent condition and with sound provenance) at any given time.

Fourth, the spread of prices in the market means that when selling it is vital to get as close as possible to the end consumer, who pays the highest price. Commissions on selling might be between 10% (the minimum at most merchants) and 25% (for example at an auction, including the buyer's and seller's premiums). Just as we buy from across the market, we also use a variety of sources to sell wines so as to maximise returns.

Fifth, provenance is an essential consideration when buying and selling fine wine. Buying 'under bond' offers reasonable security that the wine has been correctly stored since original shipment from the Château to the bonded warehouse. Wines that have additional ('strip') labels may have endured lengthy journeys and should be avoided - perfect storage is in dark, cool cellars, not on ships or planes or indeed in most private homes. The bonded warehouse system also provides a low risk, secure storage facility, reflected in the very low premiums paid for all risks insurance at full replacement value (see 'Second' above). By contrast try taking home five cases of Chateau Petrus 1990 (current value £25,000 each) and asking for an insurance quote!

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